WESCORP

March 22, 2006

VIA e-mail: regcomments@ncua.gov

Ms. Mary Rupp
Secretary to the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

RE: 12 CFR Chap. VII
Request for burden reduction recommendation; rules relating to Agency programs, Capital and Corporate Credit Unions; Economic Growth and Regulatory Paperwork Reduction Act of 1996 review

Dear Ms. Rupp:

WesCorp appreciates the opportunity to comment on this NCUA Request for Comments. Our comments are specific to the section pertaining to corporate credit unions. WesCorp has a national field of membership and serves 1,061 credit unions in 41 states, offering balance sheet solutions and payment systems services. Our capital ratios as of February 2006 are: retained earnings – 2.54 %, core capital – 3.37%, and total capital – 6.48%.

Risk Based Capital

Corporates have been advocating for a revision to our regulation to promote a risk-based standard for corporates at least since the 2000 revision to Part 704. NCUA did not go with a risk-based capital standard, but rather with a 2% retained earnings ratio and a total capital ratio – and minimal recognition for PIC**.** The trade-off included corporates being allowed to invest in lower-rated instruments but under tighter concentration limits. However, allowing corporates to take on additional credit risk is another component that strengthens the argument for risk-based capital. WesCorp and the corporate network still support a risk based capital standard for corporates. It is also important to note the corporates were at one time under a risk based capital standard – so a move to change the regulation to allow for risk based capital would not be unprecedented. In 1995, NCUA required a minimum capital ratio of risk-based capital to risk weighted assets: primary capital at 4% of risk weighted assets and total capital at 8% of risk weighted assets. There were four buckets with risk weightings of 0%, 20%, 50%, and 100%.

WesCorp has had a negative experience specifically because we do not have a risk based capital standard. Several years ago, the State of California put out a bid to the state's financial institutions for the Savings Plus Program (401k and deferred comp monies). In the process we asked if they would recognize our unique capital standards and they said yes. We then responded to the RFP using our capital standards and they subsequently penalized us for not having a risk-based capital standard. The state indicated we were not comparable to others and so did not recognize our unique capital measurements even though they said they would. As a result, we were rated quite low in the capital area and were denied the bid.

Several studies have been done on corporates: the GAO study of 1991, the "Black Study" of 1994, the Treasury Study of 1997; and the most recent GAO study released in 2004. These studies all contain a discussion on capital at corporates, and at least two suggest that risk based capital may be the most appropriate for corporates and recommends the standards specifically address credit and interest rate risk and derivative activities.

How much capital is enough? The greater the proportion of a financial institution's operations that are financed with capital funds contributed by its owners, the more likely the financial institution will be able to continue to pay its obligations during periods of economic adversity. This simple reasoning is the basis for the longstanding emphasis financial institutions regulators have placed on capital adequacy as a key element of safety and soundness. Requiring corporates to hold more capital has costs. Requiring a corporate to be financed with a greater percentage of capital in effect restricts the amount of borrowing it can support. Capital requirements can have broader macroeconomic effects on the availability of credit. According to the history of capital regulation in the United States, by 1986, regulators were concerned that the primary capital ratio failed to differentiate among risks and did not provide an accurate measure of the risk exposures associated with innovative and expanding banking activities. The original BASEL Accord established in 1988 has proven that a risk-based capital regulation is recognized to have been a stabilizing force in the international banking system, as well as a stimulus to enhance global competitive equality. This proven model can be a starting point for corporates. Basel II includes more flexibility to include customized risk models for both credit and interest rate risk, as well as adding measures to address operational risk.

We can also look to the current financial marketplace for further guidance on the issue of risk-based capital. In November 2001, the major bank regulators (FED, FDIC, OCC, OTS) adopted a major revision to the risk-based capital framework effective January 1, 2002. The concept is simple, the less risk found in an investment the less capital that must be allocated, and as the risk profile increases, a greater level of capital must be assigned to those risks. Risk based capital is good enough for other financial institutions and it is good for corporates as well. The recognition that a regulatory regimen, which rewards less risk in an institution's balance sheet and requires additional capital for greater risk is the foundation of the national and international risk-based capital standards. If this is good policy for banks and thrifts and is recognized as such by their regulators, it is certainly a concept worthy of study to explore options to make our capital structure work more effectively.

Definition of capital:
Total capital is comprised of reserves and undivided earnings (RUDE) and Paid-in Capital (PIC) and member capital (MCs), and is analogous to what other financial regulators would define as total capital. MC alone is not considered core capital, due to

its provision for returning it to its investor at the conclusion of three years when proper notice is given. This form of capital is analogous to short-term subordinated-debt.

RUDE is the total of the corporate's undivided earnings, reserves and any other appropriations designated by management or regulatory authorities. (At WesCorp, we have such an appropriation called "contingency for market fluctuation.") Solely measuring RUDE is not necessarily the best measure of a corporate's current financial health.

The current Part 704 includes two measurements of capital, total capital and retained earnings. Given the two measurements in the regulation, there is minimal recognition for PIC issued by corporates, which is perpetual debt and a solid cushion for the NCUSIF. In fact, WesCorp's outstanding PIC would qualify as Tier I capital for a bank under GAAP. PIC is very expensive capital for corporates to carry and the minimal recognition it receives in the current regulation does not offset that cost. (The recognition being the earnings retention requirement using an adjustable measure that is based on core capital which includes PIC.)

All capital is treated equally in the current Part 704 in terms of risk measurements. This fails to recognize the difference and value of long-term capital or core capital versus that of less permanent short-term capital such as MC's. WesCorp supports the importance of PIC and MC in future capital calculations. Credit unions have affirmed their ownership of their corporates in a very formalized manner, through the purchase of Membership Capital Shares (MC), and in the case of most corporates, Paid In Capital (PIC) shares. The form and structure of the MC and PIC is set forth in NCUA regulation, and these regulatory requirements specify that the shares have a designated maturity structure, are uninsured, and have a first loss priority after reserves. In addition, the dividends are non-cumulative and may be suspended in the event of financial difficulty. Further, PIC or MCS may not be redeemed if the redemption will impair the capital structure below that required by regulation. Also, the ownership of PIC carries no voting rights. Credit unions understand that the purchase of MC and PIC is equivalent to an equity stake in their corporate, and they are certainly aware that this equity stake is not taken without risk. Credit unions are provided extensive disclosures to understand these risks at purchase, and receive additional formal notifications annually. Technical issues aside, it is important to recognize that credit unions own corporates, not the other way around. MC and PIC represent the equity in credit unions that has been formally invested or "upstreamed" to their corporate or corporates.

To that end, corporates use Reserves, which by definition are the accumulated and undivided earnings of the corporate, along with PIC and MCS to create value. We use this up-streamed capital to provide a cooperative return in the form of better rates, lower fees for processing and settlement services, enhanced technology, and a safe and sound environment for the member credit union that puts its trust in us.

WesCorp believes that corporate credit unions would benefit from a regulatory standard to hold credit-risk weighted capital that is consistent with risk-based measures used by other depository institutions. This standard should adopt a credit risk-based capital requirement that is simple to administer and unobtrusive to corporate credit unions that undertake only modest credit risk.

We have submitted in the past to NCUA an outline of a suggested risk-based capital requirement. The recommendation is based on the 4 percent minimum total capital ratio combined with a minimum 8 percent risk-based capital requirement. Both measures are based on the inclusion of RUDE, PIC, and 3-year MCs in the definition of total capital. These standards are analogous to the measures imposed on other depository institutions and are in line with the current proposals for revision to the Basel Accord.

Corporates, conservative by nature, would fare very well capitalized under a comparable risk based standard for corporates. Using the proposed standards we have submitted in the past, WesCorp's capital level would be approximately 30%. This is akin to the standards used in the banking industry and inspired by BASEL. Subjecting corporates to a comparable standard would more accurately show our true capitalization to outside audiences, such as the banking industry, Wall Street, the rating agencies, other regulators, and Congress. However, given the "high" capital level under this risk based capital proposal, we also strongly suggest that NCUA does not draft a risk based capital standard with an artificially high requirement. These ratios appear high because corporates take very little credit risk. However, the revised Part 704 allows for corporates to engage in loan participations through the expanded authorities application process. That activity adds some credit risk to the balance sheet.

(Note: we are not submitting actual risk based capital standards with this letter as there is a corporate network task force assigned to draft such standards and pending corporate network approval, will be submitted to NCUA and advocated on.)

WesCorp recommends the following should be the objectives in devising a risk-based capital standard for corporates:

- To devise a standard that is simple to administer and unobtrusive to corporate credit unions who continue to undertake only modest credit, interest-rate, and operational risk
- To devise a standard that is progressive in nature and captures the incremental risk exposures above traditional investment activities
- To devise a standard that is consistent with the risk-based capital measures used by other depository institutions
- To devise a standard that is compatible with existing expanded authorities regulation and does not require the dismantling of existing capital requirements that are largely based upon potential interest rate risk exposures

WesCorp recommends the definitions of primary (or core) capital and total capital be retained in Part 704. In addition, risk-weighted capital standards should be included to provide further consistency and comparability with other regulated financial institutions. WesCorp would support a risk-based capital "trigger" for corporates. This would allow for less complex corporates to be alleviated from a risk based capital calculation unless they met certain triggers.

During the last revision of Part 704, as corporates lobbied for risk-based capital standards, NCUA took the position that they would consider risk-based capital for corporates only if the standards addressed operational risk. While most agree on the definition of operational risk ("people and systems"), holding capital specifically against such risk is a new notion in the history of capital requirements. The BASEL Committee has addressed the notion of a capital component to address operational risk at financial institutions. The technical components may differ between financial institutions, however clear strategies and oversight are the key components and commonality for all banks under BASEL II. It specifies a strong internal control culture, including clear lines of responsibility and segregation of duties, effective internal reporting and contingency planning. Again, the BASEL II assumptions can serve as a model for the corporate regulation in this regard.

Further, NCUA notes in the appendix of its own document released last year called, *Prompt Corrective Action Proposal for Reform*, that the operational risk for corporate credit unions is adequately covered by the corporate's retained earnings.

Treasury supports risk based capital for corporates. The United States Treasury Department is on public record for supporting risk-based capital for corporates, in a letter dated October 15, 2002, from the Treasury to the NCUA, and written by Acting Assistant Secretary for Financial Institutions J. Patrick Cave. Mr. Cave submitted the letter in response to proposed changes in regulation 704, and states their support for a risk-based capital framework for corporates. To quote this letter, "The benefit of a risk-based capital system is that it explicitly makes an institution's capital requirement sensitive to the risk in an institution's on- and off-balance sheet activities." Further, the letter suggests that the NCUA Board, "reconsider applying risk-based capital standards for corporates. Even the national ratings agencies support risk-based capital for corporates. They regularly suggest this would make us more comparable with other financial institutions.

WesCorp supports a leverage ratio. Worldwide, financial institution regulators have determined that there is a need for both an un-weighted minimum leverage ratio as well as a risk-weighted capital ratio. By so doing, they can better evaluate the relative capital adequacy of a financial institution in light of the risk it has on its balance sheet at any given time. Only America's credit unions are without such a measurement tool. This puts both the regulator and the regulated at a significant disadvantage. Credit union regulation has fallen out of step with worldwide financial institution regulation. We would encourage a leverage ratio that not only contain RUDE, but PIC and maybe even MCS.

A risk-based capital system provides a built-in incentive to purchase higher-rated investments. Under such a system, exposure to lower credit grades would require additional capital. In summary, the regulatory environment for corporates is rather prescriptive in terms of the activities and exposures to credit and interest rate risk, and the examination and review process is rigorous in its application. Although there are components that have a risk basis, capital is not one of them.

Future Dated ACH Accounting – Section 704.2

The issue is whether corporates should account for ACH transactions on their settlement date, which is when the funds are posted, or on the advice date when the corporate receives an advice indicating the funds will be posted on a specified future date. WesCorp encourages NCUA to exclude future-dated ACH items and uncollected cash letters from the definition of "daily average net assets" (DANA). Including such items artificially inflates the balance sheet which has the effect of requiring the corporate to hold more capital for funds that aren't there. At WesCorp, we book this at month end for regulatory reporting purposes, and it is reported as a separate line item in the 5310 report. It varies from month to month, depending on the day of the week that the last day of the month falls on, but is frequently greater than $1 billion. We follow GAAP for the rest of the month, and in our internal financials, and only record the liabilities for deposits when the deposits are actually received by us.

Setting capital aside for nonexistent monies is not the most efficient use of the corporate's money in adding value to its members. WesCorp urges NCUA to exclude future-dated ACH items from the definition of DANA. WesCorp supports calculating future-dated ACH items on a settlement date basis.

Board Governance Part 704.14(2)

This section restrains a corporates ability to have the best possible individuals in the industry serving as chairmen of our boards. As the marketplace is shrinking because of increased consolidation among both corporates and natural-person credit unions, the pool of human resources available to serve on corporate boards becomes limited. Further, the individuals that best serve the corporate as directors are the individuals who are already active in the industry serving on a variety of other boards and committees. This section does not appear to serve any purpose that ads value to a corporate's safety and soundness. WesCorp urges NCUA to remove this section from the regulation completely.

CUSOs

WesCorp urges the NCUA to agree that all forms of lending (i.e., not just mortgage lending and business lending - but also credit card lending and car loan lending, or anything else) would be deemed within the permissible powers of both natural-person and corporate CUSOs. Further, WesCorp encourages NCUA to consider allowing CUSO originated loans to be treated the same as Credit Union originated loans, in those scenarios where the corporate is empowered to trade in them (such as under Part V Expanded Authorities).

Credit Concentration Limits – Section 704.6 (c)

WesCorp finds the *general rule* of limiting credit concentration limits in aggregate in any single obligor to 50% of capital or $5 million (whichever is greater) to be inflexible in its application to the current corporate environment. Each corporate has different balance sheets and takes different risks. This *general rule* has too much of a "one size fits all approach" to regulating corporates. It does not recognize corporates that have expanded investment authorities, and therefore more infrastructure. A corporate with all the expanded investment authorities has the same credit concentration limits as a base plus corporate. WesCorp strongly urges NCUA to consider amending this section of the regulation that acknowledges the differences in corporates abilities to take on increased risk based on their expanded authorities - that have more expanded authorities should be able to engage in increased risk.

Further, WesCorp believes that the establishment of risk-based capital guidelines negates the requirement for a complex regime of limits. WesCorp would recommend a simple maximum limitation of a percent of total capital per obligor/issue, supplemented by the risk-based capital requirement. WesCorp suggests that the combination of expanded authorities, risk-based capital requirements, and a maximum individual credit exposure limit to any one obligor/issue is more than sufficient.

Correspondent Services Agreement – Section 704.12(1)

WesCorp disagrees with this section which prohibits corporates from providing financial services to nonmembers unless a correspondent services agreement is in place between the initial corporate and the current corporate of the nonmember credit union. WesCorp considers this section to be a restraint of trade within the corporate credit union network. This section has a direct impact to many corporate credit union services and is a detriment to member credit unions receiving the best services they can from the corporate network to better serve their own members. In a true free market environment, any financial institution is fair game – it should also be so for the credit union system. WesCorp urges NCUA is remove the correspondent services agreement requirement.

Merger Guidance for Corporates

WesCorp supports separate and distinct NCUA merger guidance for corporate credit unions. With the increased merger and consolidation activity in the corporate credit union network, and the likelihood that that will continue, it seems reasonable to seek out merger guidance specifically for corporate credit union mergers. Applying the natural-person credit union merger guidance to the corporate model is a less-than-efficient way to execute a merger. That sentiment was further validated by the recent GAO study on corporate credit unions: *CORPORATE CREDIT UNIONS – Competitive Environment May Stress Financial Condition, Posing Challenges for NCUA Oversight* (released September 2004).

Again, WesCorp appreciates the opportunity to comment on NCUA's Notice of Regulatory Review on Economic Growth and Regulatory Paperwork Reduction Act of 1996.

Sincerely,

Bob Siravo

Bob Siravo,
President/CEO